(5)

No. 89-1149



In The

# Supreme Court of the United States

October Term, 1989

COY R. GROGAN AND JOHN H. HENSON,

*Petitioners,*

v.

FRANK J. GARNER, JR.,

*Respondent.*

**On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

## BRIEF FOR THE PETITIONERS

MICHAEL J. GALLAGHER*
GLENN A. JEWELL
One Main Plaza, Suite 840
4435 Main Street
Kansas City, Missouri 64111
(816) 756-0030
*Counsel for Petitioners*

*Counsel of Record

## QUESTION PRESENTED

1. Must exceptions to discharge under Bankruptcy Code § 523(a) be proven by the "preponderance of the evidence" standard or by the "clear and convincing evidence" standard?

## TABLE OF CONTENTS





## TABLE OF AUTHORITIES

Page

### TABLE OF CASES

TABLE OF AUTHORITIES — Continued





TABLE OF AUTHORITIES — Continued

TABLE OF AUTHORITIES — Continued



No. 89-1149

**In The**

# Supreme Court of the United States

October Term, 1989

COY R. GROGAN AND JOHN H. HENSON,

*Petitioners,*

v.

FRANK J. GARNER, JR.,

*Respondent.*

**On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

## BRIEF FOR THE PETITIONERS

## OPINIONS BELOW

The opinion of the Court of Appeals, App. to Pet. for Cert. 1a-15a, is reported at 881 F.2d 579. The opinion of the district court, App. to Pet. for Cert. 16a-29a, has not been reported. The opinion of the bankruptcy court, App. to Pet. for Cert. 30a-41a, is reported at 73 B.R. 26.

## JURISDICTION

The judgment of the Court of Appeals, App. to Pet. for Cert. 1a-15a, was entered on August 9, 1989, and a petition for rehearing was denied on September 12, 1989. App. to Pet. for Cert. 42a. A petition for a writ of certiorari was filed on December 11, 1989. J.A. 2. The petition was granted on April 30, 1990. *Id.* The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

## STATUTE INVOLVED IN THE CASE

Bankruptcy Code § 523(a)(2)(A) provides:

> § 523. Exceptions to discharge.
>
> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> (2) for money, property, services, or an extension, renewal or refinancing of credit, to the extent obtained by —
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition[.]

(The entire text of § 523(a) appears in the Appendix to the Petition for Writ of Certiorari 43a-54a.)



## STATEMENT OF THE CASE

Petitioners originally brought suit against respondent Frank J. Garner, Jr., in the United States District Court for the Western District of Missouri. App. to Pet. for Cert. 3a. In that action a jury determined that respondent had: (1) committed common law fraud under Missouri law; (2) breached the fiduciary duty he owed to petitioners; and (3) violated section 10(b) of the Securities and Exchange Act of 1934. *Id.*

On May 8, 1985, the jury awarded actual damages on the above three counts and punitive damages on the fraud count. The Eighth Circuit Court of Appeals affirmed the jury's verdict. *Grogran v. Garner,* 806 F.2d 829 (8th Cir. 1986). *Id.*

On October 21, 1985, respondent filed a Petition for Relief under the Bankruptcy Code and requested that petitioners' judgment against him be discharged. App. to Pet. for Cert. 3a. On May 7, 1986, petitioners filed an adversary proceeding in bankruptcy court seeking a determination that respondent's debt based on the common law fraud judgment was nondischargeable under 11 U.S.C. § 523(a). *Id.* at 3a-4a.

Petitioners relied on the doctrine of collateral estoppel which precludes the relitigation of issues concluded in the common law fraud trial to support their claim that the fraud debt was nondischargeable. At the § 523 hearing the bankruptcy court admitted into evidence the following documents:

1. A copy of petitioners' First Amended Complaint filed in the common law fraud action;

2. A copy of respondent's Addendum to his Brief to the Eighth Circuit, containing several of the jury instructions, Orders entered by the district court, the verdict directing instructions, the verdict and the district court judgment;

3. The opinion of the Eighth Circuit Court of Appeals; and,

4. A letter from the Eighth Circuit Court of Appeals transmitting the opinion.

App. to Pet. for Cert. 31a-32a.

Respondent presented evidence by his testimony, denying that he had committed fraud. *Id.* at 4a.

Relying on *Brown v. Felsen*, 442 U.S. 127 (1979), the bankruptcy court concluded that "the elements to be proved under Section 523(a)(2) must be compared with the elements decided by the unanimous jury in the District Court case, and, if identical, as to content and standard, [petitioners] have borne their burden." *Id.* at 36a. The bankruptcy court found that the elements were identical. *Id.* at 37a. The bankruptcy court also addressed respondent's contention that the "preponderance of the evidence" standard applied as petitioners' burden of proof in the common law fraud case was dissimilar from the "clear and convincing evidence" standard of § 523 proceedings. Respondent argued this difference should preclude the use of collateral estoppel in nondischargeability proceedings. *Id.* at 39a. The bankruptcy court rejected respondent's contention, concluding that "there is no real distinction between 'preponderance of the evidence' and 'clear and convincing evidence' as regards Section 523 litigation." App. to Pet. for Cert. 40a.



The bankruptcy court ruled that the issue of respondent's fraud had been litigated fully, and the debtor was precluded from relitigating the fraud issue by collateral estoppel. *Id.* at 4a. Accordingly, the bankruptcy court found the fraud judgment was nondischargeable under § 523(a)(2)(A). *Id.* at 40a.

Respondent appealed to the district court, contending that a lesser standard of proof was used in the underlying jury trial than is required under § 523(a)(2)(A). *Id.* at 4a-5a.

District Court Judge Dean Whipple, in affirming the bankruptcy court's decision in petitioners' favor, stated:

> The keystone of our legal system is to give litigants a full opportunity to present their side of the litigation and allow a court or jury to reach a decision, and then abide by that decision. This has been done in this case. Appellant's trial in the U.S. District Court used Missouri Civil Instructions. Both sides were permitted to try their case in full, the jury was instructed to render a verdict based upon the facts and the law given in the court's instructions. A re-litigation of this case in Bankruptcy Court on the identical fact issues would be to permit the party who loses at a jury trial to have a second day in court on the same issue he and his opponent were fully heard previously. If permitted, all like cases would result in duplicitous litigation resulting in an unreasonable burden on the bankruptcy court.

*Id.* at 27a-28a.

Respondent appealed the ruling of the district court to the Eighth Circuit, seeking a determination that the jury's fraud verdict under Missouri law should have no preclusive effect on a subsequent bankruptcy proceeding under § 523(a). *Id.* at 5a-6a.

The Eighth Circuit determined that the verdict directing instruction in the fraud case imposed a "preponderance of the evidence" burden of proof. App. to Pet. for Cert. 8a.

The Court of Appeals noted that the courts are in conflict on the burden of proof in § 523(a) proceedings. *Id.* at 9a. The Court of Appeals stated:

> The burden of proof for fraud or any of the other exceptions from discharge under Section 523(a) of the Bankruptcy Code is far from clear. The Bankruptcy Code is silent as to the burden of proof necessary to establish an exception to discharge under Section 523(a) including the exception for fraud.

*Id.*

Resolving the noted conflict for the Eighth Circuit, the Court of Appeals determined that the burden of proof under § 523(a) is "clear and convincing evidence" and reversed the decision of the district court. *Id.* at 14a.

## SUMMARY OF THE ARGUMENT

Bankruptcy Code § 523(a)(2)(A) provides that a debt procured by false representations or actual fraud is excepted from the general discharge of debts by bankruptcy. Where, as here, the elements of common law fraud are identical with the elements necessary to except the debt from discharge under § 523(a)(2)(A), the doctrine of collateral estoppel may be used to preclude relitigation of factual issues determined by a prior judgment against the debtor.

The Court of Appeals concluded erroneously that the creditor must establish the elements of § 523(a)(2)(A) by "clear and convincing" evidence. This holding precludes the creditor from using collateral estoppel to establish



nondischargeability where the underlying judgment was obtained under a "preponderance of the evidence" standard of proof because the plaintiffs' burden would be significantly greater in the subsequent § 523(a) proceeding.

The Bankruptcy Code and its legislative history are silent on the proper standard of proof in proceedings to determine the dischargeability of claims under § 523(a). At the time the Bankruptcy Code was enacted, there was a split of authority on the issue, with some courts requiring clear and convincing evidence to establish nondischargeability and others requiring that the exceptions to discharge be proven by a preponderance of the evidence. It may not be concluded that Congress intended to favor either result when the Code was enacted in 1978, because no clear majority rule had emerged.

This question of nondischargeability involves a private dispute over money which determines merely whether a debt continues. Certain types of claims involve issues of personal liberty or important personal rights which require a greater assurance of the accuracy of the fact-finding process through the imposition of a heightened standard of proof. Where the adjudication concerns particularly important personal rights more substantial than a monetary dispute, this Court has required that these rights may not be impaired unless clear and convincing evidence supports the result. However, the instant proceeding involves a purely monetary dispute between private litigants which does not warrant the application of a burden of proof greater than that applied in ordinary civil cases.

A majority of fraud cases, including those tried under the federal securities laws, are decided on a "preponderance of the evidence" standard of proof. The judicial imposition of a higher standard in nondischargeability cases would

result in an enormous burden on litigants and the bankruptcy courts. In each case where the dischargeability of a fraud judgment is at issue, the parties and bankruptcy court would be required to retry the entire case in the § 523(a) proceedings.

Without compelling justification, different evidentiary standards of proof should not be applied in civil proceedings involving a private dispute about money.

## ARGUMENT

### I. COLLATERAL ESTOPPEL MAY BE APPLIED PROPERLY IN BANKRUPTCY PROCEEDINGS TO DETERMINE THE NONDISCHARGEABILITY OF A FRAUD JUDGMENT UNDER § 523(a) OF THE BANKRUPTCY CODE.

"[T]he whole premise of collateral estoppel is that once an issue has been resolved in a prior proceeding, there is no further factfinding function to be performed." *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 336 n. 23 (1979). Furthermore, collateral estoppel "has the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party and of promoting judicial economy by preventing needless litigation." *Parklane Hosiery Co.*, 439 U.S. at 326, *citing, Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*, 402 U.S. 313, 328-329 (1970).

In *Brown v. Felsen*, 442 U.S. 127, 139 n. 10 (1979), this Court recognized the applicability of collateral estoppel to bankruptcy proceedings, stating that "[i]f, in the course of adjudicating a state-law question, a state court should determine factual issues using standards identical to those of § 17, then collateral estoppel, in the absence of countervailing statutory policy, would bar relitigation of those issues in the bankruptcy court."



For collateral estoppel to apply under federal law the issue precluded must have been (i) identical to the issue decided in the earlier action; (ii) actually litigated in the prior action; (iii) necessary and essential to the prior judgment; (iv) determined by a valid and final judgment. *Goss v. Goss*, 722 F.2d 599, 604 (10th Cir. 1983); Restatement (Second) of Judgments § 27 (1982).

In the original trial of the common law fraud claim, the verdict directing instruction compelled a petitioners' verdict if the jury found (i) the respondent made a representation intending reliance on such representation; (ii) the representation was false; (iii) respondent knew the representation was false; (iv) the representation was material to petitioners' decisions regarding sale of their stock; (v) petitioners relied on the representation; and (vi) that as a direct result of such representation each petitioner was damaged. J.A. (Pl. Ex. 2) 39-40, 50-51, 8, 9.

The jury's verdict was unanimously in favor of petitioners and against respondent on the common law fraud count as well as the 10b-5 and breach of fiduciary duty counts. The jury awarded punitive damages upon a finding that the misrepresentations were made willfully and maliciously. J.A. (Pl. Ex. 2) 28-31, 8, 9.

In comparing the six elements above with the elements required in § 523(a) litigation, it is evident that collateral estoppel was applied properly to petitioners' fraud judgment. The elements of a nondischargeability claim for fraud under § 523(a) are:

(1) the debtor made false representations;
(2) at the time debtor knew they were false;
(3) debtor made them with the intention and purpose of deceiving the creditor;

(4) the creditor reasonably relied on such representations; and

(5) the creditor sustained the alleged injury as a proximate result of the representations having been made.

*Matter of Van Horne*, 823 F.2d 1285, 1287 (8th Cir. 1987).

The elements of common law fraud in Missouri are identical to the determination required under § 523(a). Accordingly, collateral estoppel should preclude relitigation of the nondischargeability issue.

## II. THE EIGHTH CIRCUIT'S DECISION THAT THE EXCEPTIONS TO DISCHARGE UNDER BANKRUPTCY CODE § 523(a) REQUIRE PROOF BY THE "CLEAR AND CONVINCING EVIDENCE" STANDARD IS WRONG AND IS NOT SUPPORTED BY THE STATUTORY LANGUAGE OR BY THE LEGISLATIVE HISTORY.

This Court has observed that when searching for congressional intent the language of the statute is the starting point. *Andrus v. Allard*, 444 U.S. 51, 56 (1979); *Reiter v. Sonotone, Corp.*, 442 U.S. 330, 337 (1979); *62 Cases of Jam v. United States*, 340 U.S. 593, 596 (1951). The Bankruptcy Code does not mention the standard of proof to be applied in § 523(a) proceedings to determine the nondischargeability of fraud debts.

The legislative history of § 523(a) contains no reference to the proper standard of proof. *See* 1978 U.S. Code Cong. & Ad. News 5787, 6453. Regarding § 523(a)(2)(A) the legislative history states that it "is intended to codify current case law, e.g., *Neal v. Clark*, 95 U.S. 704 (1887), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied by law." *Id.* The legislative history reflects a concern for the elements of fraud, but not for the standard required to prove that a fraud debt is nondischargeable.



The courts were split on the issue of the proper standard of proof for exceptions to discharge when the Bankruptcy Code was enacted in 1978. Congress cannot be presumed to have been following a trend on that issue. (*Compare Sweet v. Ritter Finance Co.*, 263 F.Supp. 540, 543, (W.D.Va. 1967); *Gonzales v. Aetna Finance Co.*, 468 P.2d 15, 18 (Nev. 1970); *Atlas Credit Corp. v. Miller*, 216 So.2d 100, 101 (La. App. 1968); *Household Finance Corp. v. Altenberg*, 214 N.E.2d 667, 669-70 (Ohio 1966) applying preponderance of the evidence standard, *with Brown v. Buchanan*, 419 F.Supp. 199 (E.D.Va. 1975) applying the clear and convincing evidence standard.) "The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Kelly v. Robinson*, 479 U.S. 36, 47 (1986) *quoting Midlantic National Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 501 (1986) *quoting*, in turn, *Swarts v. Hammer*, 194 U.S. 441, 444 (1904) (citations omitted). There was no judicially recognized or uniformly applied standard of proof for nondischargeability proceedings in 1978.

The Fourth Circuit has determined that the "preponderance of the evidence" standard should be applied to exception to discharge proceedings under Bankruptcy Code § 523(a). *Combs v. Richardson*, 838 F.2d 112 (4th Cir. 1988).

In *Combs*, as in the instant case, the court addressed the preclusive effect of the civil jury verdict in a subsequent bankruptcy proceeding. The bankruptcy court had determined that the jury verdict finding him guilty of assault

prevented Combs from relitigating the issue of whether the judgment was grounded upon a willful and malicious injury. Therefore, the bankruptcy court determined Combs' debt to Richardson was nondischargeable under § 523(a)(6) which states that:

> (a) a discharge under § 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual from any debt — (6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

Rejecting Combs' contention that the "clear and convincing evidence" standard should be applied to nondischargeability proceedings, the Fourth Circuit held:

> The Bankruptcy Code is silent as to the standard of proof necessary to establish the exceptions to discharge in § 523. In the face of this silence, courts may not imply a higher standard than the preponderance standard normally applied in civil proceedings. Although the 'fresh start' philosophy of bankruptcy law requires that exceptions to discharge 'be confined to those plainly expressed,' *Gleason v. Thaw*, 236 U.S. 558, 562, 335 S.Ct. 287, 289, 59 L.Ed. 717 (1915), this policy does not justify judicial imposition of a heavier burden of proof on creditors seeking to have a debt determined nondischargeable under § 523(a)(6).

*Combs*, 838 F.2d at 116.

Four Circuits are in conflict with the Fourth Circuit and have concurred with the Eighth Circuit by holding that the standard of proof for discharge under § 523(a) is "clear and convincing evidence." *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986); *In re Kimzey*, 761 F.2d 421, 423-24 (7th Cir. 1985);



*In re Black*, 787 F.2d 503, 505 (10th Cir. 1986); *Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1262 (11th Cir. 1988); and *In re Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986). However, the Eighth Circuit has acknowledged the meager authority relied upon by these courts in decisions requiring a heightened standard of proof:

> The circuits applying the clear and convincing standard have offered various explanations. All the circuits cite to various bankruptcy court decisions applying the clear and convincing standard. Two of the circuits cite to 3 *Collier on Bankruptcy*, ¶ 523.08 (15th ed. 1989) which states without explanation that the appropriate burden of proof is the clear and convincing standard. *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986); *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986). Two of the circuits state that the clear and convincing standard is necessary to overcome the presumption of innocence. *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986); *In re Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986). Three circuits offer no rationale at all for favoring the more stringent standard. *Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1262 (11th Cir. 1988); *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986); *In re Kimzey*, 761 F.2d 421, 423-24 (7th Cir. 1985).

App. to Pet. for Cert. 11a-12a.

The Circuits applying the heightened "clear and convincing" standard rely upon either bankruptcy court authority or the equivocal reference in *Collier* to support their holdings. Contrary bankruptcy authority was ignored, and no consistent rationale was offered beyond the unsupported observation that a "clear and convincing" evidentiary standard is ordinarily applied in nondischargeability

cases. *Matter of Van Horne*, 823 F.2d 1285, 1287 (8th Cir. 1987); *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986); *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986); *In re Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986); *In re Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986); *In re Kimzey*, 761 F.2d 421, 424 (7th Cir. 1985).

The Eighth Circuit expressed reliance upon the "fresh start" policy of the Bankruptcy Code for its determination that the "clear and convincing evidence" standard is the proper standard of proof under § 523(a). App. to Pet. for Cert. 13a; *Matter of Van Horne, supra*, 823 F.2d at 1287. This "fresh start" policy provides for "'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt,'" *Brown v. Felsen*, 442 U.S. at 128, *quoting, Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

Here, the "fresh start" policy has been misapplied. The Eighth Circuit has failed to give effect to the rule that "[b]y seeking discharge, however, respondent placed the rectitude of his prior dealings squarely in issue, for, as the Court has noted, the Act limits that opportunity to the 'honest but unfortunate debtor.'" *Brown v. Felsen*, 442 U.S. at 128, *quoting, Local Loan Co. v. Hunt*, 292 U.S. at 244.

Respondent has been found guilty of common law fraud under Missouri law, which conduct the jury found "willful, wanton, and malicious." J.A. (Pl. Ex. 2) 29, 47-48, 8, 9. This determination precludes him from claiming to be an "honest but unfortunate debtor."

As discussed below, a majority of states recognize that common law fraud may be proven by some formulation amounting to a "preponderance" standard. *See* Part III, *infra* at 17. The debt which petitioners seek to exclude from the general discharge is, without question, an obligation



resulting from fraud in connection with the sale of securities. A unanimous jury found the debtor-respondent had defrauded petitioners and awarded actual and punitive damages upon a finding of intentional and malicious misconduct.

The issue *sub judice* is *not* whether petitioners must prove fraud by clear and convincing evidence—that issue was decided long before the bankruptcy proceeding was commenced. The issue before this Court is whether a creditor must prove by clear and convincing evidence that his existing fraud judgment is within the exception to discharge of § 523(a) of the Bankruptcy Code. It is submitted respectfully that there is no cogent reason for imposing a heightened standard of proof in a proceeding to resolve a purely monetary dispute between private parties.

This Court has recognized often that a heightened standard of proof is appropriate in cases where a greater level of confidence in the accuracy of the fact-finding process is mandated by Due Process. These cases involve a determination of individual rights which are "particularly important" and "more substantial than a mere loss of money." *Cruzan v. Director, Missouri Department of Health*, ____ U.S. ____ No. 88-1503, slip op. at 18-19 (June 25, 1990) (termination of nutrition and hydration of person in persistent vegetative state); *Santosky v. Kramer*, 455 U.S. 745 (1982) (termination of parental rights); *Addington v. Texas*, 441 U.S. 418 (1979) (civil commitment); *Woodby v. Immigration Service*, 385 U.S. 276 (1966) (deportation proceedings); *Gonzales v. Landon*, 350 U.S. 920 (1955) (expatriation); *Schneiderman v. United States*, 320 U.S. 118 (1943) (denaturalization proceedings). However, the "imposition of even severe civil sanctions that do not implicate such interests has been permitted after

proof by a preponderance of the evidence." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389-90 (1983).

At issue in the instant proceeding is the question of whether a civil monetary obligation shall continue or be extinguished by the discharge of bankruptcy. The affected parties are private litigants with purely monetary claims at stake. As this Court observed in *Addington*:

> Generally speaking, the evolution of this area of the law has produced across a continuum three standards or levels of proof for different types of cases. At one end of the spectrum is the typical civil case involving a monetary dispute between private parties. Since society has a minimal concern with the outcome of such private suits, plaintiff's burden of proof is a mere preponderance of the evidence. The litigants thus share risk of error in roughly equal fashion.

441 U.S. at 423.

Recognizing that this Court has observed in *dicta* that the standard of proof in civil fraud cases is "clear and convincing evidence," [*e.g. Addington, supra*, 441 U.S. at 424], it is undisputed that common law fraud may be proven in Missouri under a "preponderance" standard. In fact, a majority of jurisdictions allow common law fraud to be proven by a preponderance of the evidence. *See, infra* Section III at 17. In addition, the judicially adopted standard of proof in federal securities fraud cases between private litigants under the Securities Exchange Act of 1934 is a "preponderance" standard. *Herman & MacLean v. Huddleston, supra*, 459 U.S. at 389-90. It is submitted respectfully that the decisions holding that a heightened standard of proof applies in § 523(a) nondischargeability proceedings rely on the erroneous notion that all fraud cases must be proven by clear and convincing evidence.



## III. THE MAJORITY OF STATES ALLOW FRAUD TO BE PROVEN BY "PREPONDERANCE OF THE EVIDENCE"; BECAUSE CERTAIN FEDERAL SECURITY ANTI-FRAUD ACTIONS MAY BE PROVEN BY THE SAME STANDARD, AN ADDITIONAL BURDEN ON JUDICIAL RESOURCES WILL RESULT IF THIS COURT REQUIRES EXCEPTIONS TO DISCHARGE UNDER § 523(a) TO BE PROVEN BY "CLEAR AND CONVINCING EVIDENCE."

A majority of states apply a "preponderance" standard of proof in some or all civil fraud actions[1]. Most jurisdictions have decisions which recite that fraud is never

---

[1] *First Virginia Bankshares v. Benson*, 559 F.2d 1307 (5th Cir. 1977) *cert. den.*, 435 U.S. 952 (1978) (applying Alabama law) (fraud is proved by a preponderance of the evidence); *Dairy Queen v. Travelers Indemnity Co.*, 748 P.2d 1169, 1171 (Alaska 1988) ("no more than a preponderance of the evidence is necessary to establish fraud"); *Tipp v. United Bank of Durango, Colo.*, 745 S.W.2d 141, 143 (Ark. App. 1988) ("the party who alleges and relies upon fraud bears the burden of proving fraud by a preponderance of the evidence"); *Liodas v. Sahadi*, 19 Cal. 3d 278, 137 Cal. Rptr. 635, 562 P.2d 316, 322 (civil fraud proved by preponderance of the evidence); *Goodfellow v. Kattnig*, 533 P.2d 58, 60 (Colo. Ct. App. 1975) (there is a single burden of proof in all civil actions: proof by a preponderance of the evidence); *Kern v. NCD Industries, Inc.*, 316 A.2d 576 (Del. Ch. Ct. 1973) (fraud proved by a preponderance of the evidence); *Powerhouse, Inc. v. Walton*, 557 So.2d 186, 187 (Fla. App. 1 Dist. 1990) ("the quantum of proof necessary to support an action for fraud is 'preponderance' or 'greater weight' of the evidence"); *L & S Enterprises Co. v. Great American Ins. Co.*, 454 F.2d 457, 460 (7th Cir. 1971) (diversity action applying Illinois law) ("fraud need only be proved by the preponderance of the evidence"); *Parke County v. Ropak, Inc.*, 526 N.E.2d 732, 736 (Ind. App. 1 Dist. 1988) (fraud must be proved by a preponderance of the evidence); *LaCaze v. State, Through DOTD*, 541 So. 2d 322, 325 (La. App. 3 Cir. 1989) ("Fraud need only be proved by a

preponderance of the evidence and it may be established by circumstantial evidence"); *General Elec. Credit Corp. v. Wolverine Ins.*, 362 N.W.2d 595, 601 (Mich. 1984) (fraud must be established by a preponderance of the evidence); *Crawford v. Smith*, 470 S.W.2d 529, 531 (Mo. banc 1971) (fraud is proved by a preponderance of the evidence); *Poulsen v. Treasure State Industries, Inc.*, 626 P.2d 822 (Mont. 1981) ("Fraud can never be presumed but must be proved by a preponderance of the evidence"); *Tobin v. Flynn & Larsen Implement Co.*, 369 N.W.2d 96, 99 (Neb. 1985) (fraud suits at law "must be proved by a preponderance of the evidence"); *Medivox Productions, Inc. v. Hoffman-LaRoche, Inc.*, 107 N.J. Super. 47, 256 A.2d 803 (1969) (fraud is determined in actions at law by a preponderance of the evidence); *Echols v. N.C. Ribble Co.*, 511 P.2d 566, 571 (N.M. 1973) (fraud is proved by a preponderance of the evidence. "In New Mexico, the doctrine of 'clear, strong, and convincing evidence' does not apply to burden of proof. It applies in determining whether the evidence in support of the elements of fraud is substantial"); *Maynard v. Durham and Southern Railway Co.*, 112 S.E.2d 249, 252 (N.C. 1960), *rev'd on other grounds*, 365 U.S. 160 (1961) (in an action to set aside an instrument based on fraud "the burden of proof to establish such allegation is by the preponderance or greater weight of the evidence"); *Manning v. Len Immke Buick, Inc.*, 28 Ohio App. 2d 203, 276 N.E.2d 253 (1971) ("the degree of proof necessary to show fraud in a civil action for damages is by a preponderance of the evidence." Such evidence must be clear and convincing); *Ostalkiewicz v. Guardian Alarm*, 520 A.2d 563, 569 (R.I. 1987) ("Fraud in a civil suit need only be proven by a fair preponderance of the evidence"); *Jennings v. Jennings*, S.D., 309 N.W.2d 809, 812 (1981) (fraud is proved by the preponderance of the evidence standard); *Calhoun v. Baylor*, 646 F.2d 1158 (6th Cir. 1981) (applying Tennessee law) (Tennessee law requires only that fraud be proved by a preponderance of the evidence); *Frankfurt v. Wilson*, 353 S.W.2d 490 (Tex. App. 1961) ("The burden of proof on the part of the plaintiff to establish fraud [is] by a preponderance of the evidence").

Two other states combine the language of the two standards, but the resulting standard remains "preponderance of the evidence" with "clear and convincing" indicating the quality, not quantity, of the proof. *Kristerin Development Co. v. Granson Inv.*, 394 N.W.2d 325, 332 (Iowa 1986) (the elements of fraud must be shown by "a preponderance of clear, satisfactory, and convincing evidence") *and Newell v. Krause*, 722 P.2d 530, 536 (Kan. 1986) ("clear and convincing evidence is not a quantum of proof, but rather a quality of proof: thus the plaintiff established



presumed and must be established affirmatively with "clear" or "convincing" proof. However, a careful analysis reveals that many of these decisions concern the quality or character of the proof required and not the amount or weight of evidence required to overcome the risk of nonpersuasion. Missouri is an excellent example of the divergence of meaning created by these anomalous statements.

Missouri follows the rule that civil fraud does not require proof beyond the normal civil preponderance standard. *Crawford v. Smith*, 470 S.W.2d 529, 531 (Mo. banc 1971). The Missouri pattern jury instructions requires the

fraud by a preponderance of the evidence, but this evidence must be clear and convincing in nature").

Case law from four more states indicates that fraud is to be proved by a preponderance of the evidence, although there exists case law to the contrary. *Martin v. Guaranty Reserve Life Ins. Co.*, 155 N.W.2d 744, 747 (Minn. 1968) (fraud is proved by a preponderance of the evidence) *but see, Weise v. Red Owl Stores, Inc.*, 175 N.W.2d 184, 187 (Minn. 1970) ("fraud must be proved by clear and convincing evidence, especially where a party seeks to avoid the affects of a written instrument"); *Silk v. Phillips Petroleum Co.*, 760 P.2d 174 (Okla. 1988) ("fraud may not be presumed by the jury from circumstances, it must arise as any other issue of fact from a preponderance of all the evidence") *but see, In re Darren Todd H.*, 615 P.2d 287 (Okla. 1980) ("Oklahoma is one of the jurisdictions which requires proof of fraud by clear and convincing proof"); *Gilbert v. Midsouth Machinery Company, Inc.*, 267 S.C. 211, 227 S.E.2d 189 (1976) ("while the evidence [to prove fraud] must be clear and convincing, such clear and convincing proof may be met by a preponderance of the evidence") *but see, Rutledge v. St. Paul Fire and Marine Ins. Co.*, 286 S.C. 360, 334 S.E.2d 131, 138 (1985) (standard of proof in a fraud and deceit case is clear and convincing evidence); *Hayseeds, Inc. v. State Farm Fire & Cas.*, 352 S.E.2d 73 (W.Va. 1986) ("'clear and satisfactory' in cases involving fraud or false swearing, may be defined to be a preponderance of evidence sufficient to overcome the presumption of innocence of moral turpitude or crime") *but see, Tri-State Asphalt Products v. McDonough Co.*, No. 18990 (Supreme Ct. App. W.Va. 1990) (allegations of fraud must be established by clear and convincing proof).

"preponderance" burden of proof instruction be given in fraud cases. Missouri Approved Jury Instruction 33.01 (1981). This instruction was used in the jury trial of the underlying fraud action in this case. J.A. at 106-07.

Nevertheless, the Missouri courts persist in expressing the view that fraud must be "proven" by clear and convincing evidence. *See, e.g., Centerre Bank of Independence v. Bliss*, 765 S.W.2d 276 (Mo. App. 1988); *Barrett v. Flynn*, 728 S.W.2d 288 (Mo. App. 1987). The only way to reconcile these seemingly inconsistent expressions of the Missouri law is to recognize that the burden of proof is by a preponderance of the evidence, as dictated by controlling authority of the Missouri Supreme Court En Banc. The expression of a "clear and convincing" evidentiary requirement relates to the character of the evidence--not to the quantity of evidence required to prevail.

In addition to common law fraud, cases decided under the anti-fraud provisions of the federal securities laws are proven under a "preponderance" standard. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 (1983) (private action under § 10(b) of the Securities and Exchange Act of 1934); *Securities and Exchange Commission v. Joiner Corp.*, 320 U.S. 344, 355 (1943) (action under § 17(a) of the Securities Act of 1933).

Because most fraud actions brought by private litigants are tried under a "preponderance" standard of proof, imposition of the heightened "clear and convincing" standard to nondischargeability proceedings under § 523(a) will preclude the use of collateral estoppel in most instances and will impose substantial additional burdens on the litigants and bankruptcy courts. In each instance where a fraud judgment is obtained under a "preponderance" standard, the entire action must be retried in the bankruptcy court on the issue of dischargeability.



The judicial creation of a different standard of proof in bankruptcy discharge cases is inconsistent with the normal burden placed on the parties in a civil action involving monetary claims and is unwarranted because of the additional burden it would place on the parties and bankruptcy courts. Without compelling justification, the burden of proof in bankruptcy discharge cases should be no greater than that imposed in the underlying action for fraud under state law.

## CONCLUSION

For the foregoing reasons, petitioners request that the judgment of the Court of Appeals be reversed and the case remanded to the District Court for entry of judgment in petitioners' favor on the claims under § 523(a)(2) of the Bankruptcy Code.

Respectfully submitted,

MICHAEL J. GALLAGHER
Counsel of Record

GLENN A. JEWELL

One Main Plaza, Suite 840
4435 Main Street
Kansas City, Missouri 64111
(816) 756-0030

*Counsel for Petitioners*
*Coy R. Grogan and John H. Henson*